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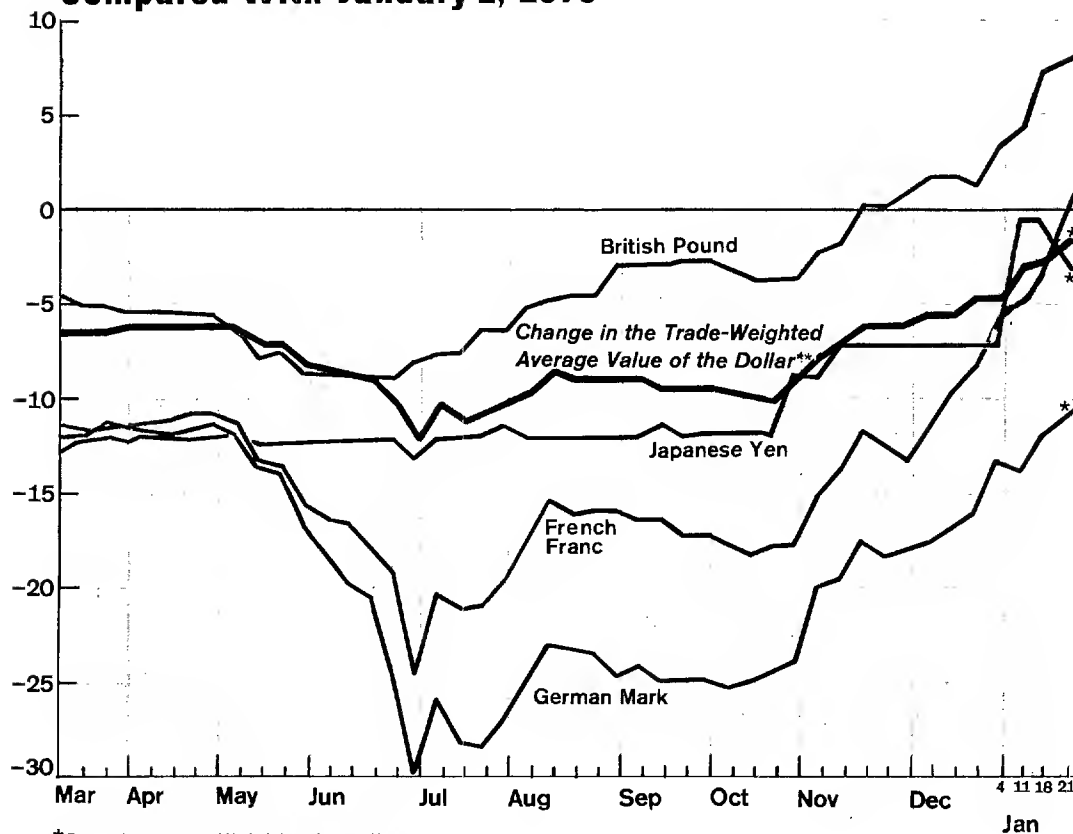
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Percent Change In the Value of the US Dollar Relative to Selected Foreign Currencies Compared With January 2, 1973



*Based on nonofficial bank trading

**Relative to 16 major currencies

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INTERNATIONAL MONETARY DEVELOPMENTS: All European money markets are open today. The European joint float will resume operations--minus the French franc--following a decision by the finance ministers of the seven countries remaining in the float to reopen their exchanges. All major West European exchanges except for London and Paris had been closed yesterday to allow officials time to assess the damage caused by the French decision to float the franc.

On the London and Paris exchanges, the franc declined by about 4.5 percent relative to the dollar yesterday, despite a reported \$75 million in official sales of dollars on the French exchange. The French apparently will attempt through moderate intervention to slow the franc's depreciation.

Other European currencies traded on the London exchange declined by smaller amounts. Sterling again closed at a record low relative to the dollar. Meanwhile, gold was fixed at a record \$138 an ounce in London--up more than \$8 over Friday's fixing.

Paris moved to reduce speculative pressure on the franc by strengthening its foreign exchange controls. Tighter restrictions were placed on foreign lending, forward currency purchases, and import payments to limit outward capital flows. Inward capital flows were encouraged by raising the maximum amount French firms can borrow abroad.

Japan's Ministry of Finance ordered the Tokyo foreign exchange market to close for an unspecified period. The Japanese will watch developments in the European money markets closely, paying particular attention to the course of the German mark, before reopening the market. If the remaining joint float currencies are allowed to depreciate further, Tokyo will almost certainly move to let the yen decline relative to the dollar. Indeed, in unofficial transactions the dollar now trades in Tokyo for about 310 yen, compared with about 300 yen last Friday. Even before last weekend's

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events, the yen was weak and there was some sentiment in the Japanese Government in favor of further depreciation.

Fears are spreading that the franc float will touch off a round of competitive devaluations by nations seeking a trading edge to offset their higher oil bills. EC Commissioner Haferkamp expressed concern, following Sunday's meeting of the Commission, over the effect this might have on European unity. International action will be needed to stem these fears.

* * * *

Rapid erosion of its exchange reserves and an anticipated large foreign trade deficit were the main factors leading to Paris' unexpected decision to float the franc. In four months France has lost \$3.2 billion, almost half of its nongold reserve assets. The oil price rise threatened a \$3-billion trade deficit instead of the \$1.5-billion surplus previously expected. Meanwhile, West Germany--France's largest trading partner and the only major country now participating in the joint float--still expects a trade surplus this year.

The floating of the franc will also increase France's flexibility in domestic economic policy. Paris will gain, for example, greater freedom to lower interest rates if economic activity should lag. Moreover, it undoubtedly is hoping that a cheaper franc will stimulate French exports and employment. Such hopes are not being voiced publicly, however, because such advantage would come at the expense of France's trading partners, particularly the other EC countries.

The French decision to float the franc will add to both the political and the economic disarray within the community that has already been evident in the energy situation. Although EC and member-state officials have generally attempted to put the best face on the French action, the almost uniformly glum press reactions are probably truer indications of both official and public assessments of

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the difficulty the community will have in coping with consequences of Paris' stand. "Understanding" for the French move is not lacking, but many commentators nevertheless wonder whether more of an effort for joint financial measures on France's part would not at least have eased the psychological impact.

France's action, which tends to draw Paris closer to London as a monetary "outsider" in the EC, threatens to polarize further the Germans from the French and British, who are already somewhat estranged from the rest of the community as a result of their oil policies.

In addition to the obvious reversal of the effort toward economic and monetary union, the French step could slow the already halting progress on community unity in several other areas. The Germans, already displeased with being the major contributor to the proposed fund for regional development, may become even more reluctant to agree to a fund that includes France among its beneficiaries. The French have been defending the EC Commission's concept of a fund to make depressed areas throughout the community eligible for aid. Bonn may now increase its arguments for a fund applicable only to the UK, Ireland, and Italy.

Abandonment of the joint float underscores France's desire to go it alone in meeting the consequences of the energy crisis and further reduces the chances of a common European approach for the energy conference to be held next month in Washington. France's action may mean, however, that on an individual basis, the EC members will be less shy about opposing French views at the conference.

The EC Commission has indicated that it will try to take advantage of the heightened EC crisis to push for concerted action on a number of fronts in an attempt to preserve community unity. The reported difficulties in scheduling an early meeting of all the EC finance ministers, however, do not augur well for Commission efforts in the immediate future.

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LAOS: There are signs that negotiations on a new coalition government may soon gather momentum.

Prime Minister Souvanna, in a private conversation with a US official on January 20, said he expects the new government to be formed early next month. According to Souvanna, Soth Phetrasy, head of the Lao Communist delegation to the Joint Commission to Implement the Agreement, expects chief political negotiator Phoun Sipraseuth to return to Vientiane later this week with a list of Pathet Lao ministers for the new government. Phoun departed Vientiane on January 16 for consultations in Sam Neua. In the past several weeks the Prime Minister has pressed his half-brother, Lao Communist leader Prince Souphanouvong, to submit such a list, but these requests have been ignored up to now. Souvanna's new optimism is in marked contrast to the gloom he exhibited in earlier discussions with US officials in Vientiane.

Soviet Ambassador Vdovine also seems more optimistic. He was scheduled to leave Vientiane on January 19 for Hanoi and Sam Neua, promising the US ambassador that he would discuss North Vietnamese troop withdrawals with North Vietnamese and Lao Communist leaders and help facilitate political negotiations on a new coalition government. Vdovine earlier blamed the Pathet Lao for delay in implementing the Lao accords and predicted that the Pathet Lao would change their negotiating tactics early in 1974. His visit to Sam Neua will mark the first time since 1969 that a Soviet ambassador has traveled to the Lao Communist headquarters.

Government and Lao Communist negotiators at the working level have been making limited progress on some of the problems associated with the neutralization of Vientiane and Luang Prabang. At the ninth plenary session of the Joint Commission on January 17, both sides agreed in principle on the size, duties, and prerogatives of the joint military forces, but no agreement was reached on the question of the joint police forces for the two cities--a point that has hamstrung deliberations in the commission for several weeks.

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JAPAN: Tokyo registered a \$10.1 billion balance-of-payments deficit for 1973. This massive outflow contrasts with a surplus of \$4.7 billion in 1972. Official foreign exchange reserves have been drawn down by one third to a level of \$12 billion.

Sharp deterioration occurred in both the trade and capital accounts. The trade surplus fell to \$3.8 billion from \$9.0 billion in 1972 as a business upswing and soaring commodity prices pushed up the import bill by 70 percent. Exports rose nearly 30 percent, with almost all the increase reflecting higher prices. Export volume grew slowly because of resistance to higher prices on some products and the inability to keep up with the demand for others. Roughly half the decline in the global trade surplus resulted from a narrowing of Japan's surplus with the US.

The net outflow of long-term capital jumped from \$4.5 billion in 1972 to a record \$9.7 billion in 1973. Investment abroad increased in response to Tokyo's relaxation of capital controls and the rising cost of production in Japan. Tokyo also encouraged Japanese banks to expand substantially their overseas lending activity in the course of the year.

Japan's balance of payments will register another large deficit in 1974. Higher oil prices alone will boost the import bill by at least \$11 billion, and exports will have to increase relatively fast to avoid a trade deficit. Tokyo already has moved to discourage capital outflows and encourage inflows. A large net capital outflow is expected, however. Under these circumstances, downward pressure on the yen is likely-- at least in the months immediately ahead.

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AUSTRALIA: Australia informed Seoul yesterday that it has decided to proceed with negotiations aimed at recognizing North Korea and establishing diplomatic relations. Canberra will wait until Seoul has had a chance to respond, but the Australians have made clear that their decision is firm.

Canberra opened a dialogue with Pyongyang shortly after the Labor government came to power a year ago.

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Australian recognition--the first by a major Western power--will give another boost to Pyongyang's international standing. Australia has reassured South Korea that it has no intention of downgrading ties with Seoul, and it has also attempted to ease South Korean annoyance by promising to encourage socialist countries to recognize Seoul. Besides being in line with his desire to broaden diplomatic contacts, Prime Minister Whitlam may look on recognition of North Korea as a concession to left-wingers in his party and another demonstration of Australian independence of the US.

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FOR THE RECORD*

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Libya: President Qadhafi apparently decided to cancel without explanation the nationwide referendum on the Libyan-Tunisian union that had been scheduled for January 18. The agreement is still being portrayed as on track, but the Libyan media have submerged the entire fiasco in sporadic, low-key coverage. [REDACTED]

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US-USSR: Kaiser Industries is pursuing a Soviet invitation to participate in a ten-year project to construct a major aluminum complex with related mines and fabricating facilities. The estimated cost of the project is some \$3 billion. Kaiser officials and Soviet representatives are scheduled to meet today in Moscow. [REDACTED]

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